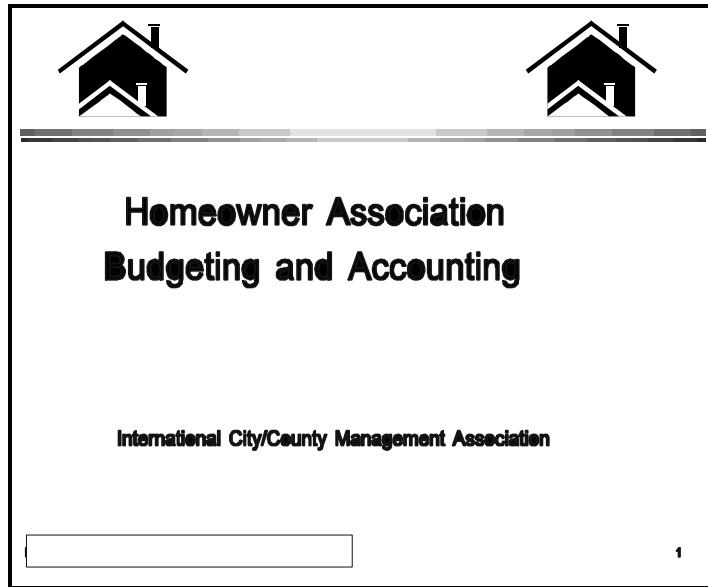


# Homeowner Association Budgeting and Accounting Course

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## **Course Agenda**

10:00	Welcome and Introductions
10:45	Budgeting: Purpose and Process
	How a Budget is Used
	Setting and Maintaining Standards Through a Budget
11:15	Budget Preparation
	Zero Based Budgeting VS. Historical Trends
11:35	Tea Break
12:10	Budget Components
	Budgeting for Income
	Maintenance Fees
12:20	Expense Budget
	Replacement Fund Budget
	Calculating the Replacement Fund
	Communication
1:00	Lunch Break
2:10	Financial Statements
	Comparison to Budget Statement
2:20	Income and Expense Journals, and Delinquencies
3:00	Tea Break
3:20	Balance Sheet
3:40	Income Statement
	Audits
4:05	Review
4:15	Close



## **WELCOME**

International City/County Management Association (ICMA), funded by the United States Agency for International Development (USAID), offers a complete set of

courses on starting and operating Homeowner Associations (HOAs). These courses are intended to teach people how to be responsible HOA board members.

This course is designed to teach Homeowner Association Budgeting and Accounting to help HOA Directors fulfill their duties and responsibilities. It is not designed to teach accounting skills or to teach people to become HOA accountants.

ICMA's other courses on HOAs include:

- .Overview and Formation of HOAs
- .HOA Organization and Operations
- .HOA Maintenance and Contracting
- .HOA Problem Solving and Rules

Persons who serve as HOA Chairmen, Board Members or Managers, and active HOA participants or local officials involved with HOAs should consider taking the complete set of courses.

### **Objective of this Course:**

To acquaint the participants with the basic method of homeowner association budgeting and accounting techniques and procedures, including:


- .What is a budget and why have one
  - .Budgeting for income
- .Maintenance fees and expenses
  - .Replacement fund budget

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- .Budget preparation -- zero based vs. historical trends
- .Financial Statements including: income and expense journals, delinquency statements, income and expense reports, and balance sheet
  - .Audits

## Introductions

- | Talk with your neighbor for 10 minutes
- | Find out about relevant background and interests
- | Present information to group (1 minute each)



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## INTRODUCTIONS

Participants should be **seated in random order** so that they are **seated next to a person they do not know**.

If this is a course with the same

participants, people should introduce someone different than the prior course(s) and include new information in the introduction. The participants should **be paired off in groups of two**. They should **interview one another** for about five minutes each.

The following information should be obtained during the interviews:

- .Name
- .Position
- .Name of HOA
  - .City/Rayon
- .Number of apartments and buildings served by the HOA
  - .Professional background and experience
  - .Length of period involved with HOA
    - .Personal objectives for HOA
  - .Biggest problem facing their HOA

The introductions will take approximately one minute per person. This information will prove quite valuable in the seminar. It is important that notes be taken by the participant so that peers can be met and questions can be directed at appropriately knowledgeable participants.

## BUDGETING: PURPOSE AND PROCESS

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**ISSUE:** *What is a budget and why make one?*

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### ● **Creating a Budget:**

Conceptually, an annual budget is a document which is used to estimate a HOA's income and expenses. It is a planning tool and a road map. As a road map, the budget is used to guide the work of management for comparison during the year to determine the HOA's situation. For planning purposes, the budgeting process works in two ways:

- 1) An estimate is made of all expected costs for the year. That total cost is then translated into a fee per apartment based on the number of square meters, and
- 2) The HOA evaluates whether or not the fee is reasonable for the owners to pay. If the fee is low, perhaps additional services could be added. If the fee is too high, then costs must be reviewed, and services eliminated, performed more economically (such as by volunteers), or deferred.

After revisions are made, the fee is again calculated. This process is continued until an acceptable fee is reached.

This process is expense based. It may be natural tendency to skip the analytical steps required to determine the real expenses, since, for example, one might believe that there is no possibility to pay for everything that is needed. The simple approach would be to make expenses conform to expected income - an income-based approach.

However, the income-based approach prevents the HOA from fully exploring its needs. The expense-based method forces the documentation of needed or desired work, and then allows the Board to make informed choices as to the work it wishes to pursue next year, and what work it will defer.

The Board must prepare the budget, and "sell" both the fee and the budget to the General Assembly.

### ● **The Budget Describes:**

A. **What** services will be provided. Examples include utilities, trash collection fees, management, accounting services, legal services, cleaning and maintenance.

B. **When** services will be provided. As part of the budgeting process, it

is typical to include when ( e.g. as needed, winter only) and how often ( e.g. monthly, annually) services will be rendered. This helps to determine how much services will cost and when payment is due. Also, if the association knows it will need to paint the building, it should include that information as part of the budget, so the funds are available to pay for the painting.

C.**How** the services will be provided. For example, some services (such as utilities) are typically provided by other entities. Other services, such as repairs and painting, are performed on an “as needed” basis by an employee or contractor. If agreements have been made with owners so that they will provide services in lieu of cash payments, this information should be included in the budget as well.

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*Group Exercise (10 minutes): Ask groups of three to six participants list of all the expense and income categories they know. The example be detailed: ¼not just “maintenance”, but “roof maintenance” system maintenance”, “plumbing repairs”, etc.*

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## HOW IS A BUDGET USED?

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***ISSUE:*** *Budget serves many purposes.*

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- **Basis For Determining Assessments** - As mentioned previously, the budget (which includes anticipated income and expenditures), is used to determine monthly assessments. Careful planning in the preparation of the budget can provide realistic figures for expenditures.
- **Provides Control Element In Financial Statements** - The budget helps to provide a control element in financial statements. The budget should be used as a guide or “target” to help the homeowner association determine if it has under or over-estimated the amount of the expenditures. If significant deviations from the budget (the *expectations* of what the expenditures should be) occur, the Board of Directors should try to determine why. Inadequate control over expenditures or service providers (vendors or contractors), or other financial problems, such as a high number of delinquencies, may be indicated.



## THE BUDGET - SETS AND MAINTAINS STANDARDS

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***ISSUE: Budgets promote planning***

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● **Establishes Community Standards** - People have a right to expect a reasonable level of service from the homeowner association. For instance, it would be reasonable to expect utilities to be provided with a minimum of interruptions each month, certainly none caused by non-payment of the bill. It is also not unreasonable to expect things to work, such as lights, elevators, etc. People also expect to live in a fairly clean environment, which again is not unreasonable.

● **Helps Plan Activities** - The budget is often used to plan activities, whether they be large maintenance actions (such as painting, replacement of sidewalks, etc.) or even social events. By placing the planned expenditure of funds to support these activities in the month(s) in which they are expected to occur, the budget helps to *remind* the Board of Directors of plans they made. If an expenditure is planned for which *saving* of funds will be required before accomplishment can occur, these can be placed in the budget for the month in which the savings are expected to be complete.

● **Minimizes The Unexpected** - The budgeting process helps to minimize the unexpected as the Board of Directors plans for all known and anticipated income and expenditures and puts them in the budget. For instance, if the HOA knows that they spent 12,000 tenge for utilities last year, and as a result budgets 1,000 tenge per month for utilities for the current year, it is fairly sure that there will be some months during which the cost is less than that, and others that will be more. If five months of the year have passed and 4,000 tenge have been spent on utilities, it should not be surprising when one month's utility bill is 1,200 tenge.

If the Board of Directors knows in advance which months will have higher utility bills, they can plan the budget accordingly and allot more money in the higher months, and less in the lower months. Likewise, if it is known that particular expenditures will only be necessary in certain months, placing them in those months aids in the planning process and helps to minimize the unexpected.

● **Helps Balance Needs And Desires With Resources** - There are

some expenditures which must be made, but there are others which are “nice to have.” By listing the expected income and expenses for the whole year, the Board of Directors can determine whether or not the homeowner association can afford any of the “nice to have” items. There may be a situation in which there are not sufficient funds to pay for even the necessities. If this is the case, it is obvious that additional income will be necessary or a conscious decision can be made to defer or go without the particular item, such as a working elevator.

If funding is needed for a large replacement expenditure, the budgeting process may reveal that insufficient funds will exist to pay for the large expenditure in the current year. The budgeting process should reveal for how many years funds have to be accrued to pay for the large expenditure. In order to achieve this type of budget, it is necessary to base the income the homeowner association expects to receive in realistic terms.

## PREPARING A BUDGET

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**ISSUE:** *How to create the budget framework.*

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● **Determine Mandatory Line Items** - The first step in preparing the budget is listing all of the line items that are to be included. Mandatory line items would include all of the income line items and all of the normal, recurring operating expense line items that the HOA knows it will have to pay. Depending on the particular situation, some or all of the following would be included: utilities, repairs, management, personnel costs, routine maintenance, cleaning and/or janitorial services. Future replacement items, whether they can be funded in the current budget year or will have to be “saved for,” should be listed; any available funds should be assigned to them.

● **List And Decide On Discretionary Items** - Discretionary items are those which would be “nice to have”, but may not fit into the budget. The Board of Directors should list all items which they would like to be able to fund, and then eliminate those which are too low on the priority list to allow funding. An example of a discretionary item is a new sign for the building or repairing the playground equipment.

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*Group Exercise (10 minutes): From the list prepared earlier, have the group identify the mandatory and discretionary items.*

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## ZERO BASE BUDGETING VS. HISTORICAL TRENDS

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**ISSUE:** *Starting from zero*

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Historical Trend budgeting determines what the average spending levels were in recent years for each category of expense. Assumptions must then be made regarding whether costs are expected to be higher or lower, and by how much, based on various circumstances. For instance, if the HOA expects to install weather stripping around all windows of the building, it would be normal to expect that there will be a reduction in utility costs. The difficult part is determining how much utility costs are expected to be in the future. A decision may be made to continue funding utilities at the same level as in the past until the amount of the cost-savings can be determined. In general, due to inflation of prices over time, if there are no other factors that will significantly affect costs either up or down, it is normal to expect that costs will increase.

In Zero Base Budgeting, one starts with a “clean slate” and decides what services are absolutely essential to have, and then determines how much it will cost to obtain those services.

A useful approach in this process looks at this year’s activity, and asks the questions how many or how much will it take to do it next year, and at what performance level. Was the result adequate? Other approaches include looking to communal Housing Department Standards, and user/owner satisfaction.

This type of budgeting is much more difficult to perform, although it may be necessary for the first year and then useful every few years in the life of a HOA to develop a Zero Base budget. The advantage to this type of budgeting is that it takes nothing for granted with regard to services that the HOA has. In preparing this type of budget, the Board of Directors may find that there are services the HOA can do without, thereby reducing expenses to the HOA.

Some HOAs also find it useful to ascertain and compare costs that other HOAs incur for certain items. Since all buildings are different this is not an appropriate way to budget, but it may be a useful for management purposes.

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*Group Exercise (5 minutes): Have the groups list questions they would ask various line items when doing Zero Based Budgeting.*

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## BUDGET COMPONENTS

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### **ISSUE:** *What makes up a budget?*

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#### ● **Income**

*- Income is the money the HOA will receive to support activities. The primary source of income is owner assessments, but there are other sources as well. Other sources include interest received on idle funds in the bank, rents for commercial space, and any money received from fines.*

*There may be other sources of income available to the homeowner association, such as leasing rooftop space for a contractor to install antennas, microwave towers, or cellular telephone antennas. Some homeowner associations may collect commercial rents or lease space for a kiosk or parking.*

*Income is usually categorized in the budget based on its source, but it is also advisable to segregate income into intended use, i.e., operating income and reserve or replacement income. While it is preferable, after determining what the operating and replacement fund needs are, to allocate the correct amount to both funds, sometimes this cannot be done. If the owners cannot afford to pay the full amount needed for both funds, some homeowner associations will put enough funds into the operating account to cover those expenditures, while all funds that are left over are put into the replacement or reserve fund. If reserve or replacement funding is done in this manner, a special assessment of owners may be required at some point in the future to pay for a needed replacement or replacements.*

● **Expenses** - *Expenses are categorized by how they are spent. Included in operating expenses are things like utilities, routine maintenance, management fees, cleaning expenses, insurance, and so forth. In general, operating expenses are those that happen on a recurring, relatively short-term basis.*

● **Reserve Or Replacement Fund** - *Income for replacements should be designated or earmarked for that purpose. Additionally, when expenditures are made for replacement of capital items such as sidewalks, painting, paving, elevators, or large scale replacement of items, such as staircases (as opposed to replacing a couple of boards on a staircase), these expenditures are considered *replacements* and should be funded from the reserve fund.*

Later we will discuss how the Reserve Fund is calculated.

## INCOME - BUDGET

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### ***ISSUE: Sources of income***

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- **Assessments** - Assessments paid by owners are usually the largest source of income for the homeowner association. Sometimes these are the only source of income that can be relied upon. Normally, income from assessments will be divided into operating funds and reserve or replacement funds.
- **Interest** - Interest is money paid by financial institutions for keeping money invested with that institution. If the homeowner association can earn interest on money it has in the operating fund, the interest earned is termed operating interest. Interest earned on money in the reserve or replacement fund is called replacement or reserve interest.
  - **Penalty Fees Or Fines** - If the homeowner association collects penalty fees (such as for late payment of assessments or fines), these funds are included in income. While there is some historical basis in what the association can reasonably expect to collect in penalty fees or fines, it is usually best not to include these in the income estimates. That is because these items are too uncertain to count on. Ideally, everyone will pay their assessments on time and no one will be fined!
- **User Fees** - These are fees collected from persons who use certain facilities or services. For instance, it may be permissible to charge rent for use of the space for a kiosk or other commercial purpose. Some homeowner associations may realize funds in the future by installing laundries or charging for parking spaces. Any expected user fees generated should be included in income.
- **Commercial Rents** - A homeowner association may be fortunate enough to have space that it can rent or lease commercially. Money collected from these rentals should be included in income. If there is a lease on commercial space that expires six months into the year, the HOA may only be able to collect rent until the expiration of the lease. If the lease holder's situation changes or finds another space to rent that costs less, the association may not be able to collect a full year's rent, or the rent for the second half of the year may be less.

## MAINTENANCE FEES

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***Issue:*** *How to determine how much each owner should pay in fees.*

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● **Maintenance Fees: Determining Amount To Charge** - Determining the amount to charge for monthly maintenance fees is not something that should be taken lightly. It is *inappropriate to guess* the amount the maintenance fees should be. This is something that requires research and careful thought. In determining the amount to charge, it is necessary to prepare a budget. This is discussed in more detail later, but basically the homeowner association has to determine what they expect their operating expenses to be. They then have to determine how much they need to put in the reserve or replacement fund, so enough money is on hand when the time comes to replace “capital” items. If the *amount needed for operating for the year* is added to the *amount needed to be set aside in the replacement fund*, the Board of Directors will then know how much money they need to collect from the owners. By dividing that amount by 12 months, the Board of Directors will know how much they need to collect per month. Dividing the amount needed for each month by the number of total square meters in the building and then multiplying this factor by the number of meters in each apartment lets the Board of Directors know how much they need to collect from each owner each month.

## EXPENSE - BUDGET

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**ISSUE:** *Types of expenses*

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- **.Operating** - All normal, recurring expenses should be placed under operating expenses.

A.Management: There is usually an expense to pay for the chairman's or manager's salary.

B.Utilities (in some buildings): In buildings where utilities (or some portion of them) have to be paid, this is considered a normal, recurring, operating expense. As mentioned previously, it may be preferable to budget more money in the months in which usage is expected to be high, and less in months when usage is expected to be low.

C.Janitorial and cleaning services: The cost of this expense is usually fairly uniform, which lends itself well to the budgeting process.

D.Repairs: Include routine repairs, such as replacement of a rotten board, or minor repairs to a piece of machinery belonging to the association.

E.Personnel: Personnel costs such as wages or salaries are normal, recurring operating expenses.

F.Taxes: Taxes are routine, normal, recurring operating expenses.

G.Major improvements: This item is based on the building's needs and the owners' wants and desires.

H.Bad Debt Allowance: Accounts for unrecoverable non-payment of monthly fee by some owners. This line adjusts income down from potential to actual, helping to ensure adequate income to cover expenses.



## RESERVE/REPLACEMENT FUND - BUDGET

***ISSUE:*** *What are examples of replacement fund i*

- **.Roof** - Roof replacement is a reserve/replacement item in the budget. Significant repairs, such as replacement of an entire section of a roof, would also be considered a replacement fund item. A small repair, such as correcting a minor leak, would be considered an operating expense.
- **.Lifts** - Lifts often have major expenses associated with their upkeep and repair. Replacement of any major components such as motors, cable systems, or control panels would be reserve / replacement fund items.
- **.Overhaul Plumbing** - A major project such as replacing significant portions of the plumbing system, or replacement of any major component of the plumbing system would be reserve/replacement fund item(s).

## CALCULATING THE REPLACEMENT FUND

**ISSUE:** *How much should be reserved?*

1. Identify all items that will need to be replaced in the future.

1. To determine the amount needed to be set aside in the reserve/replacement fund, it is necessary to determine the *estimated remaining useful life* for each item such as painting, replacement of roofs, replacement of lift equipment, replacement of sidewalks, replacement of paving, and, if applicable, replacement of the siding on the building.

2. Once the *estimated remaining useful life* has been estimated, the current replacement cost of each item must be determined. To perform this step, it may be necessary to get contractors to bid on what they would charge to replace the item.

3. Knowing the *estimated remaining useful lives* and the *replacement costs*, it is possible to determine how much money needs to be set aside in the reserve/replacement fund *this year* in order to be able to fund the replacement when the time comes. The following formula is used to make this computation for each item:

1. Then add together this

Current replacement cost <b>[subtract]</b> current funds on hand	
-----	= Annual Reserve Amount
Remaining useful life, in years	

year's portion of the replacement cost for all items. The sum represents the true amount that should be collected for the reserve account for this year.

**By recalculating annually, the HOA does not have to guess at future inflation or other price increases.**

Example of Reserve Calculation:

●.Facts:

- Roof will last 10 more years.
- .It will cost 120,000 tenge.
- .Association currently has 20,000 tenge.

●.Reserve Calculation:

Current replacement cost <b>[subtract]</b> current funds on hand	
-----	= Ann
Reserve budget remaining useful life, in years	

**Step 1:**  $120,000 - 20,000 = 100,000$

**Step 2:**  $100,000 / 10 = 10,000$  Reserve per year

<b>(120,000 - 20,000)</b>		<b>100,000</b>	
-----	=	-----	= <b>10,000</b>
<b>10 years</b>		<b>10 years</b>	

## Sample Reserve Schedule

*Based on a 100 unit building in which all the apartments are the same size. Cost amounts are for illustration purposes only.*

*Note: if the apartments are different sizes, the amount of charge is based on the apartment's size. This is determined by dividing the total square meters in the entire building and then multiplying that by the number of square meters in each apartment.*

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*This is the process that an HOA should use to establish a **capital reserve or replacement fund**. After going through this process, owners can understand the decisions to make capital reserve.*

*Individual Exercise (10 minutes): Have each participant develop a budget schedule based on the following information:*

- ..100 unit building, all apartments are the same size.*
- ..Roof has 10 years remaining life, will cost 120,000 tenge, 60,000 tenge of funds are now on hand.*
- ..Plumbing system has one year of life, will cost 20,000 tenge, the HOA currently has 8,000 tenge on hand for this purpose.*

*Review each participant's schedule to make sure it is complete and realistic.*

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**SAMPLE ANNUAL BUDGET**

**XYZ Condominium Association, Inc.  
Annual Budget  
for the Year Ending December 31, 19X2  
(With Comparative Totals for 19X1)**

	<u>19X2</u>		<u>19X1</u>
	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
<b><u>REVENUES</u></b>			
Member assessments	\$74,700	\$24,700	\$99,400
Interest		4,900	4,600
Commission: collection utility fees		14,100	9,100
Other	2,200		2,200
<b>TOTAL REVENUES</b>	<b>76,900</b>	<b>43,700</b>	<b>120,600</b>
<b><u>EXPENSES</u></b>			
Wages and payroll taxes	29,400		28,400
Utilities	16,000		16,000
Roofs		14,400	16,000
Service and contracts	12,900		12,900
Exterior building		9,400	9,800
Repairs and supplies	9,200		9,200
Insurance and licenses	5,000		5,000
Office supplies, bank charges	2,800		2,800
Income taxes	100	1,100	1,300
Legal fees		1,000	1,000
Plumbing equipment		500	500
Heating equipment		500	500
Parking lot		400	400
Play ground			2,000
Depreciation	300		300
Bad debts	200		200
New sign for building			1,800
<b>TOTAL EXPENSES</b>	<b>75,900</b>	<b>27,300</b>	<b>103,200</b>
<b>Excess of revenues over expenses</b>	<b>1,000</b>	<b>16,400</b>	<b>17,400</b>

## **Communications**

<b>ISSUE:</b> Owners are the Board's clients. The Board is informed.
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*The budgeting process should actually begin and end with the homeowners. In the beginning the Executive Board must seek homeowner input both in terms of desired services and in terms of ability to pay for the same. The Board needs to calculate operating expenses and reserve fund needs, to arrive at total expected expenses. Expenses divided by the total number of square meters gives the fee/sq.m for each unit. Then the process of determining an acceptable fee was carried out by adjusting expenses appropriately to meet income, in an iterative series of steps.*

*The final and crucial part of the process is for the Board of Directors to communicate to the owners, in advance of the HOA Annual Meeting, what the budget does and does not provide for in terms of current year services and reserve funds for future replacements. The Board does this by writing a letter to HOA members with a copy of a proposed budget at the end. In many HOAs, the Board of Directors finds it beneficial to write notes that explain the basis and rationale for each line item in the budget. The notes serve as a record of why a certain amount was budgeted. The Board should send the letter and budget either to all owners, post it at each stairwell, or both.*

*An important point for the Directors to remember is that homeowner satisfaction is correlated to their expectations. Not communicating, or communicating the wrong expectation is a formula for unhappy owners.*

- **Educating Owners** - After the amount to charge has been estimated by the Executive Board, it is necessary to inform the owners about the amount of their assessments, and it is usually proper to inform and educate the owners as to how the figures were calculated. This is often done by providing them with a copy of the annual budget. The budget should be published and/or posted for the owners, and a Board of Directors member must be available either at a meeting or one-on-one to explain the budget.

In addition to educating owners regarding the amount of assessments and how the figures were calculated, it is also important they understand the

impact on the homeowner association of non-payment and the actions the homeowner association will take in the event of non-payment.

- **Reaching Consensus** - It is best if the owners are in agreement on the assessments to be charged. Their education and even participation in determining the amount of the assessments are important to reach consensus. At a minimum, the directors on the Board of Directors should be in agreement regarding the amount of the assessments.

- **Housing Allowance - An Alternative To Cash Payment** - Some owners may be able to use their housing allowance credits to pay their assessments.

Some owners may wish to provide work in the form of service to the HOA as an alternative to cash payment. Two examples of such services would be cleaning service or doing the bookkeeping for the homeowner association. If provision of the work reduces expenses that would otherwise be incurred by the association, then a “win/win” situation exists. The owner who provides the work in lieu of cash payment does not have to provide money that he/she probably does not have, and the association receives a service for which they would otherwise have to pay cash..

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*Group Exercises (15 minutes):*

- 1. Draft a sample annual budget with at least 6 expense categories and income categories. Include reserve income and expenses as well.*
  - 2. Write a letter from the Board of Directors to the homeowners explaining the new budget.*
  - 3. After receiving the reports, have the class members ask questions of the groups. The teacher should ask questions to expose weaknesses in communication.*
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## FINANCIAL STATEMENTS

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***ISSUE:*** *Purpose of financial statements.*

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● **Defines Financial Position At A Given Time** - Usually issued monthly, the statements indicate the HOA financial position at the end of the month or other time period.

● **Demonstrates:**

A. Income - The financial statement will list all of the income received by the HOA during the month or period covered.

B. Expenses - The statement will list all of the expenses paid during the period by the association.

C. Net Income - Net income is the difference between income and expenses. If the association receives more than it expends during the time period covered, it will have positive net income (or gain). If the HOA spends more than it receives during the time period covered, it will have negative net income (or loss).

D. Assets and liabilities - The financial statement will also list the assets and liabilities of the HOA. Assets would include prepaid taxes, prepaid insurance premiums, or prepaid salaries or services. Liabilities include items for which the service has been received, but the payment has not yet been made, or any monthly assessments paid in advance.

● **Important to Review** - It is important for the Board of Directors to review their financial position monthly. This action will help to reveal any problems in the income or the expenses, and will show how the association is doing in relation to their budget.

## COMPARISON TO BUDGET STATEMENT

The Comparison to Budget is one of the most useful of all of the statements and schedules contained in the financial statement. A properly prepared Comparison to Budget lists in one column the actual income and expenses for the period, and in the next column, the budgeted income and expenses for the period. In the last two columns, it will list the budgeted income and expenses for the period as a number and as a percent, and the difference between actual income and expenses for the period. It is also typical for the Comparison to Budget to list the actual income and expenses Year-To-Date, and in the next column budgeted income Year-To-Date. Similarly, it should provide the differences between the actual income and expenses for the Year-To-Date against the budgeted income and expenses Year-To-Date both as a number and as a percent.

Budget Comparison Example:

	<b>Actual</b>	<b>Budget</b>	<b>Percentage</b>	<b>Difference</b>
Income	10,000	12,000	83.33%	(2,000)
Repairs	2,000	2,500	80.00%	500
Cleaning	<u>1,000</u>	<u>1,000</u>	<u>100.00%</u>	<u>0</u>
Total Expense	3,000	3,500	85.71%	500
Net Income	7,000	8,500	82.24%	(1,500)

In this example, although the association had positive net income for the period, the amount of the net income is less than what was budgeted.

● **Identifies Difference Between The Plan (Budget) And Actual** -

Both income and expense differences can be readily observed. From an analysis of these differences, the Directors can see how their budget is being implemented.

- **Notifies** - The Comparison to Budget alerts owners, Directors, and the manager of differences between the budget and actual income and expenses. If there are financial irregularities, they may appear in this statement.

● **Spurs Necessary Action** - If action to increase collection of assessments or reductions in expenses is needed, the Comparison to Budget will help to spur the appropriate parties to action.

## INCOME AND EXPENSE JOURNALS, AND DELINQUENCIES

The Income Journal details the way in which funds were received: from whom, when, and how much. It may also list the method of payment. Similarly, the Expense Journal lists bills that were paid: to whom, when, and for how much.

● **Details Each Transaction** - These details can become important if there is a dispute over the amount to be paid or any discount offered for early payment. This information is also useful for determining total amounts paid to a particular vendor or contractor over a given period of time or for ascertaining how much was spent on a given category of expense over a specific period of time.

● **Provides Itemized Record** - The itemized record is useful for determining total expenses in a particular category or for a specific period of time.

### **Happy Owners Condominiums** **Operating Income Journal**

_____(Month), _(Year)				
<u>Date</u>	<u>Income Description</u>	<u>Payer</u>	<u>Amount</u>	<u>How Paid</u>
03/17/96	23B 03/96 Assess.	Mrs. Bhurin	30	Cash
03/20/96	14A 03/96 Assess.	Mr. Kashkov	20	Cash

### **Happy Owners Condominiums** **Operating Expense Journal**

_____(Month), _(Year)				
<u>Date</u>	<u>Expense Description</u>	<u>Vendor</u>	<u>Amount</u>	<u>How Paid</u>
03/17/96	Purch. 2 liters paint	Ivan's Paint	140	Petty cash
03/20/96	Purch. 1 bag concrete	Ivan's Conc.	1600	Cash
03/20/96	Repair plumb. leak in unit 24C (sink)	Ivan's Plumb	12	Petty cash

- **The Delinquency Report** - indicates which owners have not paid their fees, and for how long they are delinquent.

**Happy Owners Condominiums**  
**Delinquency Report**

_____ (Month), _ (Year)				
<u>Apt.</u>	<u>Name</u>	<u>Amount of</u> <u>Delinquency</u>	<u>Days Delinquent</u>	<u>Action</u>
0317	Ivan Golicof	250	30	Personal visit
0320	Vadim Shrimif	500	60	Letter of Notice
0346	Olga Dim	<u>750</u>	90	Court Action
Total Delinquency		1000		

*Group Exercise (15 minutes):*

*Each group should discuss:*

- 1. How often and why financial statements should be reviewed by the Directors.*
- 2. How many people should sign bank withdrawal slips and why?*
- 3. What is the purpose of the:*
  - Income Journal*
  - Expense Journal*
  - Delinquency report*

## BALANCE SHEET

A balance sheet presents a current financial picture of a company, and is meant to show all assets and liabilities as of a date certain. By comparing the current period results to the previous period, one may gain a sense of the direction of the company.

### Basis of Accounting

There are three methods associations can use to keep their books:

- .Accrual - reports expenses and income ***when earned or incurred.***
- .Cash - reports expenses and income ***when payment is made or received.***
- .Modified Cash - reports expenses and income ***when payment is made or received and includes a statement of unpaid fees and bills owed.***

Generally, the western accounting standard is the Accrual Basis because it is the most complete and contains the greatest amount of information about the financial position.

A summary of the differences in the basis of accounting reflects:

<u>Level of Completeness</u>	Most complete	Least complete	All information, but not incorporated
How receivables are reported	Reported on Balance Sheet and Income Statement	Not reported	Reported on auxiliary schedule
How payables are reported	Reported on Balance Sheet and Income Statement	Not reported	Reported on auxiliary schedule
When expenses are reported	Reported when incurred	Reported when paid	Record as in cash basis, but reported on an auxiliary schedule when incurred, but prior to payment
When income is recorded	Reported when payment becomes due	Reported when payment is actually received	Reported on an auxiliary schedule when payment becomes due before payment is made

The American Association of Certified Public Accountants requires that

HOAs prepare their annual financial reports on the accrual basis because it gives the most information. The Cash Basis Statement should not be used because it does not provide complete information.

For example, if a HOA with a 100,000 tenge in the bank owes 200,000 tenge:

- .Using a Cash Basis Statement the Association would not report the unpaid liability, therefore the fact that the liabilities are in excess of assets would not be shown.
- .A Modified Cash statement would report the liability on a separate schedule but it would not be included in the Balance Sheet or the Income Statement.

The Accrual Method would include the 200,000 liability in both the Income Statement and the Balance Sheet, clearly indicating that liabilities exceed assets.

- **Shows How Much Belongs to the Association** - The Balance Sheet provides a statement of cash in the Operating Fund and the Replacement Fund. It also shows money owed to and by the Association, and accrued depreciation
- **Fund Balance** - Fund Balance is the assets less liabilities. This is often referred to as equity. It is the value or net worth of the organization. The total liability plus equity will always equal the total assets. If it does not, the balance sheet is miscalculated.

How a Balance Sheet Works

$$\begin{aligned} \text{Assets} &= \text{Liabilities} + \text{Fund Balance (Equity)} \\ &\text{and} \\ \text{Assets} - \text{Liabilities} &= \text{Fund Balance (Equity)} \end{aligned}$$

An example of what a Balance Sheet might look like is shown on the following page:

**XYZ Condominium Association, Inc.**  
**Balance Sheet**  
**as of December 31, 19X2**  
**(With Comparative Totals for 19X1)**

	19X2		19X1	
	Operating Fund	Replace-ment Fund	Total	Total
<u>ASSETS</u>				
Cash and cash equivalents	\$11,000	\$36,400	\$47,400	\$29,800
Assessments receivable	2,800		2,800	900
Prepaid expenses	700		700	700
Due from operating fund		2,000	2,000	
Due to replacement fund	(2,000)		(2,000)	
Equipment, net of accumulated depreciation of \$800 and \$500	2,100		2,100	1,700
TOTAL ASSETS	\$14,600	\$38,400	\$53,000	\$33,100
<u>LIABILITIES</u>				
Accounts Payable	\$ 2,000	\$ 400	\$ 2,400	\$ 600
Wages payable	600		600	
Income taxes payable		100	100	500
Prepaid assessments	2,000		2,000	1,500
TOTAL LIABILITIES	4,600	500	5,100	2,600
<u>FUND BALANCES</u>				
(EQUITY)	10,000	37,900	47,900	30,500
TOTAL LIABILITIES AND FUND BALANCES	\$14,600	\$38,400	\$53,000	\$33,100

**The accompanying notes are an integral part of the financial statements. Usually, along with the Balance Sheet come explanations of larger items, or those that are unclear or unusual. .**

**THE  
INCOME  
STATEMENT**

This  
statement

*Individual Exercise (10 minutes):*

*Make a Balance Sheet based on the following facts:*

- . Operating cash 1,000 tenge*
- . Fee owed to the HOA 200 tenge*
- . Bills the HOA owes 300 tenge*
- . Wages the HOA owes 100 tenge*
- . Taxes owed by the HOA 750 tenge*
- . Reserve fund cash 100,000 tenge*

provides a "snapshot" of the income and expenses for the year or month.

There are only five columns on this report (from left to right): type of revenue or expense; whether the income or expense applies to the Operating Fund or Replacement Fund; total for both funds; and the total for the previous year (for comparison purposes). At the end of the listing of *revenue sources*, revenues are totaled by category (Operating Fund, Replacement Fund, and Total.) Similarly, at the end of the listing of *expense categories*, expenses are totaled by category (Operating Expenses, Replacement Expenses, and Total). The final column in this section provides *last year's figures* for comparison purposes.

The line following Total Expenses is **Excess of revenues over expenses**. This item provides the *profit* or *loss* the association had for the year. That is, this figure is the amount the association had left over after expenses were deducted from income. If expenses exceeded revenues for the year, then the line item will contain negative numbers. This section is also divided into Operating Fund and Replacement Fund categories, and it contains the total from the previous year for comparison purposes.

The next section states what the **Beginning Fund Balances** for each category were at the beginning of the year (These should match the Ending Fund Balances for the previous year). The total **Beginning Fund Balance** for the previous year is included for comparison purposes.

The following section lists any inter-fund transfers. If the Operating Fund had to "borrow" money from the **Replacement Fund** (or vice versa), these inter-fund transfers are listed in this section. If there are no inter-fund transfers during the year, this section is omitted.

The last section provides the **Ending Fund Balances**. This shows the balance in the Operating Fund at the end of the year. It also shows the



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balance in the Replacement Fund at the end of the year, the total for both funds, and the total for the previous year for comparison purposes.

## **INCOME STATEMENT**

**XYZ Condominium Association, Inc.  
Statements of Revenues and Expenses  
and Changes in Fund Balances  
for the Year Ended December 31, 19X2  
(With Comparative Totals for 19X1)**

	<u>19X2</u>			<u>19X1</u>
	Operating Fund	Replacement Fund	Total	Total
<b><u>REVENUES</u></b>				
Member assessments	\$74,700	\$24,700	\$99,400	\$90,900
Interest		4,900	4,900	4,600
Commission: utility fee collection		14,100	14,100	9,100
Other	2,200		2,200	2,200
<b>TOTAL REVENUES</b>	<b>76,900</b>	<b>43,700</b>	<b>120,600</b>	<b>106,600</b>
<b><u>EXPENSES</u></b>				
Wages and payroll taxes	29,400		29,400	28,400
Utilities	16,000		16,000	16,000
Roofs		14,400	14,400	16,000
Service and contracts	12,900		12,900	13,400
Exterior building		9,400	9,400	9,800
Repairs and supplies	9,200		9,200	6,100
Insurance and licenses	5,000		5,000	4,600
Office supplies, bank charges	2,800		2,800	1,800
Income taxes	100	1,100	1,200	1,300
Legal fees		1,000	1,000	
Plumbing equipment		500	500	200
Heating equipment		500	500	
Parking lot		400	400	2,000
Playground				1,200
Depreciation	300		300	300
Bad debts	200		200	
New sign for building				1,800
<b>TOTAL EXPENSES</b>	<b>75,900</b>	<b>27,300</b>	<b>103,200</b>	<b>101,000</b>
Excess of revenues over expenses	1,000	16,400	17,400	5,600
Beginning fund balances	8,000	22,500	30,500	24,900
Transfer from replacement fund	1,000	(1,000)		
<b>ENDING FUND BALANCES</b>	<b>\$10,000</b>	<b>\$37,900</b>	<b>\$47,900</b>	<b>\$30,500</b>

**The accompanying notes are an integral part of the financial statements.**

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**Again, like with the Balance Sheet, notes explain any unclear or unusual items.**

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*Individual Exercise (10 minutes): Make an Income Statement Based on the following facts:*

- *.Operating income (member assessments) 23,000 tenge*
  - *.Commercial rent 1,200 tenge*
  - *.Wages paid 15,000 tenge*
  - *.Taxes on wages 1,500 tenge*
  - *.Parts for repairs 1,000 tenge*
  - *.Late fees paid by apartment owners to the HOA 30 tenge*
  - *.3,000 tenge of Reserve Income (member assessments/reserve) received*
  - *.8,000 tenge Reserve expense for roofing*
  - *.Beginning balance 100,000 tenge Reserve*
  - *.Beginning balance 18,000 tenge Operating Fund*
-

## PERIODIC AUDITS

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***ISSUE: Audits confirm the accuracy of financial reporting***

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### ● **Examination Of Accounting Records**

- An audit is an independent examination of an organization's accounting records, and financial policies and procedures. Conducted by an independent firm with no ties to the association, or by an audit committee of the Board apart from the chair and accountant, it provides an unbiased view of the finances and financial procedures of the HOA. The audit includes a review of all the organization's records, including Board of Directors and general assembly communications and meeting minutes.

● **Verification(s)** - The audit provides verification of the association's cash position. This is done by physically counting cash on hand, and receiving independent verification of the amounts in the bank directly from the bank.

● **Confirmation** - The audit also independently confirms:

- Income
- Expenses
- Assets
- Liabilities

### **Audits can be performed by:**

- **Outside accounting firms**
- **Internal audit committee (separate from the Board of Directors)**

### **Audit Techniques**

● **Trace And Confirm Transactions** - Typically an audit also "spot-checks" transactions by talking to all parties involved in the transaction and reviewing receipts and other papers to verify that the transaction occurred as recorded and reported. Sometimes auditors will write to vendors or contractors who were involved in financial transactions to determine the validity and accuracy of the transaction.

● **Review Invoices, Inventories And Balances** - In addition to "spot-

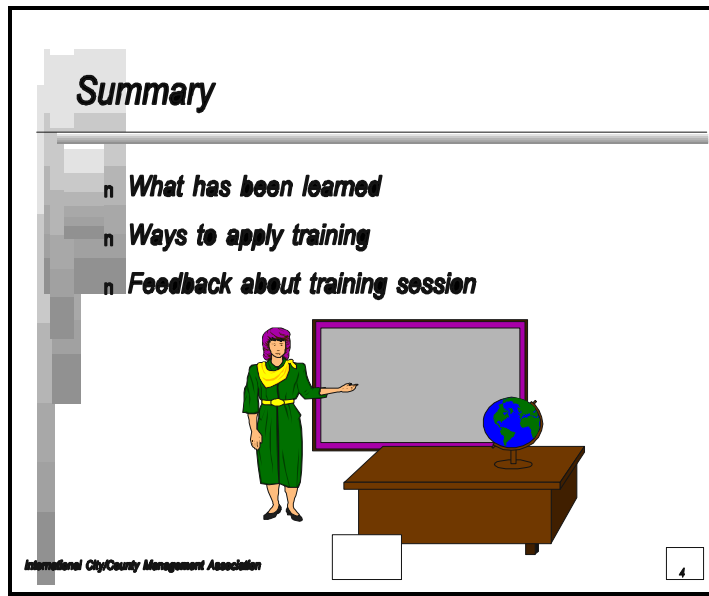
checking” transactions, an independent auditor will review all invoices to ensure they were issued for legitimate products or services. Also, they will independently review bank balances and conduct inventories of association property to ensure accurate inventory records are being maintained.

● **Analyze Policies And Procedures - Are They Appropriate, Adequate, And Followed?** - The independent auditor will determine what the policies and procedures are regarding financial transactions, what checks and balances are in place, and determine who the responsible parties are for complying with the financial policies and procedures.

A determination regarding the appropriateness and adequacy of the financial policies and procedures will be made. If there are inadequacies or if policies or procedures are inappropriate, recommendations or suggestions to improve the policies or procedures will be made to the Board of Directors.

Finally, the independent auditor will determine if the policies and procedures that have been adopted are being followed. It does no good to have policies and procedures to protect the financial position of the association if they are not being followed.

WHAT  
LEARNED:



HAS BEEN

- .What is a budget and why have one?
- .Budgeting for income
- .Maintenance fees and expenses
- .Replacement fund budget
- .Budget preparation --

zero based vs. historical trends

- .Financial Statements including: income and expense journals, delinquency statements, income and expense reports, and balance sheet
- .Audits

How can the information discussed help directors to do their job, and serve homeowners more effectively?

How can this course be improved?

What kind of future training should ICMA provide?


### Where to Get More Information

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Contact ICMA for:

- | Free monthly newsletter
- | Other training sessions
- | Books, articles
- | Electronic sources
- | Consulting services

International City/County Management Association



**CONTACT  
ICMA FOR  
MORE  
INFORMATION**

ICMA publishes various booklets, provides courses, and issues a monthly newsletter to which people can subscribe for

free.

Call, e-mail, fax, or visit ICMA for more information at:

115 Begalina Street  
Almaty, Kazakstan 480100  
Tel/Fax: (3272) 61-65-11; Phone: 60-17-53, 50-70-32  
E-mail address: [icmaoff@common.icma.alma-ata.su](mailto:icmaoff@common.icma.alma-ata.su)

or contact the nearest ICMA regional coordinator:

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We encourage class participants to attend additional courses, and to share the knowledge that they gained with others, for example by writing an article for their local newspaper or teaching a class regarding homeowner associations.

Interested persons can e-mail (in English) Paul Mengert, a HOA consultant to ICMA, at: [PMengert@aol.com](mailto:PMengert@aol.com)



**Homeowner Association  
Budgeting and Accounting Course**

**Kazakhstan**

**August 1996**

Prepared for the U.S. Agency for International Development,  
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Office of the Environment, Energy and Urban Development,  
Urban Development and Housing Division

By  
Paul K. Mengert and John Stern

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Shelter Sector Reform Project for  
the Newly Independent States and the Former Soviet Union

## **ABSTRACT**

This is a course instructor's guide for "Homeowner Association Budgeting and Accounting" prepared by Paul Mengert and John Stern, ICMA consultants in Kazakhstan, under Task Order No. 110. It includes the course agenda, course protocol and procedures, course format, and sample exercises for course participants.

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